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Extraordinary Meeting of Governors
of African Central Banks on the
Establishment of an African
Monetary Fund

Abidjan, Côte d'Ivoire
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LC/NAIROBI

PROPOSALS FOR ACCELERATING THE ESTABLISHMENT OF AN AFRICAN MONETARRY FUND

I. INTRODUCTION

1. The Lagos Plan of Action adopted by the African Heads of State and Government in April 1980 decided that "an African Monetary Fund should be established" as a means of co-ordinating the monetary policies of African countries. There was a recognition that the African Monetary Fund would provide a mechanism through which African countries can protect themselves and respond more effectively to the unfavourable international monetary and financial environment. Six years later, the African Heads of State and Government adopted Africa's Priority Programme for Economic Recovery, 1986-1990 (APPER) which inter-alia called for "strengthening of subregional and regional monetary and financial institutions and in this respect measures should be undertaken for an early establishment of the African Monetary Fund". Furthermore, in June 1986, the Special Sesson of the United Nations General Assembly on the Critical Economic Situation in Africa adopted the United Nations Programme of Action for African Economic Recovery and Development 1986-1990" (UN-PAAERD) which also called for the "intensification of efforts for the establishment of an African Monetary Fund".

2. The mandate and political commitment to establish the African Monetary Fund have been given, but action at the technical level has been slow and tedious. A feasibility study which was prepared in 1984 was discussed at three seperate meetings of experts from the ministries of finance and central banks. Their recommendations were submitted to the meeting of the Conference of African Ministers of Finance held in June 1986 at which Governors of Central Banks were invited.

3. However, a number of important issues remained to be resolved. The purpose of this brief paper, therefore, is to review these issues as a basis for further discussion and to suggest ways of accelerating the establishment of the African Monetary Fund.

II. CONCLUSIONS AND RECOMMENDATIONS OF THE FEASIBILITY STUDY

4. In order to provide a technical basis for the establishment of the African Monetary Fund, a study entitled "The Establishment of an African Monetary Fund: Structure and Mechanism" was jointly prepared by experts from the Economic Commission for Africa (ECA, the Organization of African Unity (OAU), the African Development Bank (ADB), the African Centre for Monetary Studies (ACMS) and the African Institute for Economic Development and Planning (IDEP) 1/. The study made the following recommendations:

A. Objectives and Functions

5. The African Monetary Fund (AMF) should have the following objectives, which are not exhaustive:

(i) To contribute to the economic development and social advancement of its member States by evolving an African monetary system which would command the confidence of its members through monetary and financial co-operation at the African regional level, and which would serve as a consultative machinery for encouraging more balanced economic growth in the member States.

(ii) To assist in providing financing for balance-of-payments support to member States experiencing deficits in their current account balances with a view to correcting such imbalances and safeguarding their economic growth through appropriate policy adjustments which take into account the critical development needs of the member States.

1/ United Nations, The Establishment of an African Monetary Fund: Structure and Mechanism (A Technical Feasibility Study), Addis Ababa, 22 January 1985

(iii) To promote stability of the African currencies through appropriate stabilization policies, including exchange rate systems, at the national, subregional and regional levels.

(iv) To promote the liberalization of exchange control regulations and eventual elimination of payments restrictions among the African countries through the promotion of convertibility of national currencies and acceptable par values and to facilitate the linkage of existing subregional clearing and payments arrangements for the purposes of enhancing intra-African trade and co-operation.

(v) To assist member States in instituting appropriate long-term "economic reformation" and stabilization programmes specifically geared to deal with the African socio-economic crisis arising from long-term effects of balance-of-payments problems and especially geared to capital mobilization and a more rational use of development resources.

(vi) To provide a machinery for the harmonization of monetary, currency and banking legislation and practices among African countries, harmonize the issue of national currencies, with a view to promoting their convertibility, including the use of a Common Unit of Account and to design mechanisms for overcoming the problems arising from the multiplicity of currencies and currency zones with a view to the eventual establishment of an African common currency.

(vii) To provide technical assistance and advisory services to member States on fiscal, taxation and budgetary policies and on the development of appropriate domestic and monetary institutions to deal with effective management and utilization of financial resources for socio-economic development.

(viii) To co-ordinate and harmonize the position of member States in international negotiations on monetary and financial issues so as to maximize their common interests and to contribute more effectively to the solutions of the world's monetary problems.

(ix) To undertake such other functions and activities as may be provided for in the Articles of Agreement establishing the African Monetary Fund.

B. Resources of the African Monetary Fund

6. The study analysed this question under a number of headings: (a) the identification of resource requirements; (b) the determination of the size of initial authorized capital of the AFM; (c) the general principles governing the allocation of capital subscriptions among members; and (d) other possible sources of funding.

7. The determination of the financial resources of the African Monetary Fund and the size of its initial authorized capital calls for very careful consideration. The success of AMF depends to a large extent on the political commitment and willingness of its members to pay their subscriptions regularly and promptly. An issue constantly borne in mind in this study has been the need to avoid placing too heavy a burden of capital subscription on individual member countries without, of course, unduly limiting the capacity of the Fund to meet the needs of its members. It may be therefore, necessary to establish a "ceiling" and a "floor" for subscriptions. Two options for the initial authorized capital of AMF are considered: US$3 bilion and US$2 billion. Three sub-options for paid-in capital are given for each. The critical element is that a "trigger" amount of capital must be put at the disposal of the Fund, otherwise its lending operations will be insignificant. For this amount, the study proposes a sum of US$1 billion. Of course, operations such as research, technical assistance and advisory services could still be carried out even before the above sum is reached. A second critical issue is whether to open the capital subscriptions to external participation. Depending upon the decision taken, the cash flows of AMF and the subscriptions of the African countries will vary markedly.

8. Regarding the method used to determine the allocation of capital subscription, the study recommends the adoption of one of three proposed formulae, namely (i) a combination of the African Development Bank formula with the International Monetary Fund formula; (ii) a formula based on 60 per cent of adjusted Gross Domestic Product plus 40 per cent of foreign trade; and (iii) adjusted Gross Domestic Product. Individual member subscriptions to initial authorized capital of either US$3 billion or US$2 billion have been calculated using each of these formulae.

9. The need is also recognized to augment capital subscriptions from other sources. It is suggested that the management of the Fund should raise additional funds from both concessional and non-concessional loans, accept deposits from African institutions and solicit grants and donations from the international community.

C. Lending Criteria, Policies and Procedures

10. The establishment of the criteria and procedures for lending by AMF is a very complex exercise, because the majority of Africa countries are not only in need of balance-of-payments suport, but also, in the United Nations sense, "least developed". The devastating impact of the wide-spread drought in Africa, which in some cases has brought about permanent changes in economic infrastructure, makes the task harder.

11. Therefore in setting out the lending policies and procedures of the African Monetary Fund outlined in Chapter IV, the following two considerations were taken as axiomatic:

(a) Africa's own institutions must have sufficient flexibility in its lending policy to take due cognizance of the problems facing its members in an interdependent world of depressed commodity prices, increasing inflation and interest rates, declining volumes of world trade, increasing protectionist tendencies, mounting external debts and chronic balance-of-payments deficits; it must take special account of the current economic crisis facing the developing African countries;

(b) The African Monetary Fund must sustain its credibility and the confidence of the international community by adopting sound and prudent lending policies; it must take care not to be portrayed as an institution for "easy credit".

12. In its lending operations, it is strongly recommended that AMF should apply certain basic criteria to all credits and other financial facilities along the following lines: (a) a country applying for financial assistance must demonstrate real need for balance-of-payments support; (b) it must have been a member of the AMF for at least six months before applying for such support; and (c) it must be up to date with its subscriptions to the Fund. Other conditions, specific to each form of financing facility, would also apply.

13. Four types of short-term financing facilities have been proposed, namely (i) Balance-of-payments Financing Facility (BPFF); (ii) Stand-by Financing Arrangements (SFA); (iii) Special Financial Arrangement for Intra-African Trade (SFAIT); and (iv) Special Food Financing Facility (SFFF). In addition to these Special Facility Funds have been proposed to meet needs arising from special circumstances such as drought, desertification and other natural disasters.

14. Because of the deep-rooted nature of the impacts of balance-of-payments deficits on Africa's economies, the study also proposes other facilities to assist member countries with "economic reformation" to correct imbalances of a medium or long-term nature. The medium and long-term facilities would focus on development financing oriented towards permanent solutions to balance-of-payments deficits and the related development problems.

D. Organizational Structure

15. It is proposed that the Fund should have the following organs:

(i) A Board of Governors

(ii) A Board of Executive Directors, to oversee the day-to-day running of the institution

(iii) A Managing Director and a Deputy Managing Director; and

(iv) A general secretariat.

16. The Board of Governors, on which all members would be represented, would be the highest decision-making body. It is proposed that Board of Executive Directors should have a total of twelve Executive Directors, of which two might be appointed by external subscribers if the Fund is open to external participation. In addition to the office of the Managing Director, which will also include a Legal Office, the following five departments are proposed: (i) a Department of Administration and Conference Services, (ii) a Department of Credit, Finance and Treasury; (iii) a Policy, Planning and Programmes Department; (iv) a Research and Statistics Department; and (v) a Department of Technical Assistance, co-operation and Human Resources Development.

E. Viability of the African Monetary Fund

17. A widely-debated issue is whether the proposed AMF can be a viable institution. This is discussed in Chapter VI. It must be understood that any discussion on the viability of such an institution can at the very best be speculative. However, on the basis of projections on inflows of member country subscription payments, incomes generated from Fund's own operations, investments and borrowing, it has been possible to draw general conclusions. The Fund's institutional viability has been examined on the assumption that its proposed lending facilities will be activated selectively as funds become available. The level of administrative expenditures incurred has also been taken into account.

18. The number of programmes implemented should depend both on the availability of resources and on the impact which each programme is likely to have on the economies of African countries. This study shows that the Fund can operate as a self-sustaining financial entity, and offer facilities that can really make a difference to its members' economic fortunes, with relatively modest injections of capital from each individual African country and no support from outside the region. In theory, therefore, it is proven viable. In practice its viability will depend on the political commitment of the African countries, which must be willing to subscribe their allotted portions of capital promptly. This is crucial, because as is the case with similar institutions, capital subscriptions are expected to be the major source of funding for a long time to come.

F. Co-operation with other institutions

19. From the analysis of the problems facing the African countries in the monetary and financial fields and the methods proposed for their solution, it is self-evident that co-operation between the proposed AMF and other institutions will be imperative. Chapter VII examines some of the areas where such co-operation would be useful. The Fund will need to establish functional and institutional relationships with other such institutions so as to avoid duplication of activities and wastage of resources. Common sense suggests that such co-operation may increase the level and quality of technical assistance and support which the Fund can offer to its member States, and hence its viability.

20. In brief, recent upheavals in the world monetary and financial system and the inability of present methods and policies to deal adequately with the African crisis have engendered a need for "economic reformation" on the African continent. Experience has shown that the African economic and social crisis cannot be easily resolved without the full involvement of the monetary and financial sector. Self-sustained economic growth through "economic reformation", the restoration of new-devastated agricultural and industrial

production capacity and a solution to the continents growing balance-of-payments problems can only come about under a stable monetary and financial regime, managed and monitored by Africa's own institution. Similarly, African economic recovery requires a sound regional monetary institution, capable of commanding the necessary confidence in the African countries and abroad through self-discipline and through the adoption of acceptable systems of international monetary and financial management. This, then, is the raison d'être for an African Monetary Fund.

III. MAJOR UNRESOLVED ISSUES

21. The second meeting of the Conference of African Ministers of Finance held in Libreville, Republic of Gabon, in June 1986, considered the recommendations of the experts from member States on the establishment of an African Monetary Fund. However, the following issues still remained unresolved:

(a) capital of the African Monetary Fund: (i) the size of the initial authorized capital; and (ii) the currency in which subscriptions should be paid and whether part of such subscriptions should be paid in national currencies

(b) determination of the size of the Board of Executive Directors;

(c) determination of eligibility for membership in the African Monetary Fund;

(d) whether or not to allow external participation in the membership of the African Monetary Fund.

22. A ministerial committee called "The Committee of Libreville" was established to propose ways of resolving the above issues and of speeding

up the establishment of the African Monetary Fund 1/. Its first meeting was held in Libreville from 31 March to 2 April 1987. While the Committee did not find solutions to all the issues, it endorsed the proposal put forward by the experts that the initial authorized capital should be fixed at 7 billion AUA (African Units of Account) 2/ of which 750 million AUA will be called and paid in during the first five years. Of that amount, 500 million AUA will be paid by Regional Members and 250 million by non-regional Members if they were allowed to participate in the capital of the Fund.

23. With regard to the size of membership of Board of Executive Directors, the Committee decided that the Board of Executive Directors should be composed of nine (9) Executive Directors of whom six (6) would represent regional members and three non-regional members. The Committee also decided that the Executive Directors should not reside at the headquarters of the Fund and approved the method of electing Executive Directors as outlined in schedule B of the Draft Articles of Agreement of the African Monetary Fund.

24. The Committee of Libreville were unable to reach a decision on the following issues (a) regional membership in the Fund; (b) whether or not part of the subscription should be paid in national currencies and in what proportion; and (c) whether to open membership for non-regional participation.

1/ The Committee of Libreville is made up of Gabon, Tunisia, Sierra Leone, Uganda and Zambia. All other African countries are entitled to participate in its deliberations.

2/ 1 AUA = 1 SDR (Special Drawing Right of the International Monetary Fund).

IV. PROPOSED MEASURES TO SPEED UP THE ESTABLISHMENT OF THE AFRICAN MONETARY FUND

A. The Need for Urgent Action

25. The need for the establishment of an African Monetary Fund has become more urgent during the past five years for the following reasons:

(a) During the past eight years, the African economic, monetary and financial environment have deteriorated into a crisis which threatens the very foundations of economic growth and development. Domestic incomes and savings as well as private foreign investment in many African countries are too low to support viable economic activities. Moreover, inflation and balance of payments deficits have become chronic and make it difficult to implement appropriate monetary policy;

(b) At the end of 1987, Africa owed over US$220 billion with an annual debt service obligation of about US$35 billion. The external debt service obligations of African countries continue to grow at the rate that cannot be sustained by the existing financial resources. Moreover, resources are being diverted from development and growth-oriented projects and programmes to meet the debt service obligations;

(c) Since the early 1980's, the international monetary and financial indicators show continued volatility of the international monetary system as evidenced by the following characteristics: (i) exchange rate fluctuations of major world currencies especially the US dollar *vis-a-vis* the other currencies in which international trade is denominated; (ii) real interested rates still remain very high; (iii) international economic recession which was accompanied by

the collapse in commodity prices and the decline in export earnings affects African countries more adversely than the rest of the world; (iv) there is a decline in resource inflows into Africa, especially on concessional terms. This is aggravated by significant outflows of capital and other resources from Africa through principally the activities of transnational corporations and their transnational banks; (v) IMF's adjustment programmes which entail the adoption of policies and measures have invariably proved to be deflationary by nature and had contractionary effects on national incomes partly due to the non-flexibility conditionality attached to the access to IMF's resources;

(d) There is a consensus emerging that the African monetary policies need the full backing and support of a strong and autonomous institution. The African Monetary Fund if established could therefore provide the means for African countries to deal more effectively with the current monetary and financial crisis.

B. Proposed Solutions to unresolved Issues

26. Since the second meeting of the Conference of African Ministers of Finance on the Establishment of an African Monetary Fund held in June 1986, consultations with African monetary authorities have continued so as to find mutually acceptable solutions to the outstanding issues. Based on these consultations there is a consensus emerging that the African Monetary Fund should be established without further delay. Governors of African Central Banks should agree to resolve the issues listed below with the spirit of understanding and compromise. The following proposals have been made as a basis for discussion and decision:

a) Authorized Capital of the Fund

27. The feasibility study proposed an initial authorized capital of 2 billion AUA. However, since early 1985, when the recommendation was made, considerable

changes have taken place in the economic and financial situations of the African countries. Domestic monetary and financial structures find it increasingly difficult to mobilize adequate resources for balance-of-payments support. There is now evidence to support the view that the proposed amount of authorized capital cannot be adequate to effectively support balance-of-payments shortfalls arising out of medium and long-term structural problems. Moreover, recent experiences in the ADB and the World Bank have demonstrated that issues of General Capital Increase are generally very sensitive and difficult to resolve once members have agreed on a given amount. Therefore, serious consideration should be given to fixing the "initial authorized capital" at 5 billion AUA with the understanding that the "called-up" capital could be decided at low percentages each time as and when desired. This is to avoid the problem of envisaging a general capital increase within a period of less than ten years.

(b) Payments of subscriptions

28. It is proposed that payments of subscriptions should be paid in AUA only (or convertible currency) and that no portion of such subscriptions should be paid in national currencies. Experience in similar institutions shows evidence of tremendous difficulties in the use of national currencies for Fund operations.

(c) Size of the Board of Executive Directors

29. The Committee of Libreville proposed that the Board of Executive Directors should consist of nine (9) Executive Directors and nine (9) Alternate Executive Directors. Out of this, if non-regional participation is allowed, three (3) Executive Directors and three (3) Alternate Executive Directors could be elected from non-regional members.

(d) Membership in the African Monetary Fund

30. It is proposed that the "original members" of the African Monetary Fund should be those African States who are members of the African Development

Bank and whose governments have become parties to the Agreement establishing the African Monetary Fund.

31. A State which is not an original member may become a member upon accession to the Agreement Establishing the African Monetary Fund and on terms and conditions that may be stipulated by the original members.

(e) Non-Regional Membership

32. Based on the experience of the African Development Bank Group, it is proposed that membership in the African Monetary Fund should be open to non-regional participation on terms and conditions to be agreed by its members. There is ample evidence to suggest that non-regional participation would strengthen the capital base of the African Monetary Fund and would facilitate negotiations for raising funds from the developed countries and their national and international banking and financial institutions.

C. Follow-up Action

33. On the basis of the foregoing, it is proposed that African countries should consider adopting the following measures to speed up the establishment of the African Monetary Fund:

(a) A Contact Group should immediately be established to be responsible inter-alia for (i) speeding up the preparations for the establishment of the African Monetary Fund; (ii) making necessary contacts at appropriate levels, with African Ministers Responsible for Finance as well as financial and monetary institutions both within and outside Africa to facilitate its creation; and (iii) providing technical support and advice to the Conference of African Ministers of Finance on their meetings related to the establishment of the Fund. The membership of the Contact Group should be made up of the current chairman of the Association of African Central Banks (who will be its chairman); the Chairmen of the subregional Associations of African

Central Banks; the Governors of BEAC and BCEAO; and the Executive Secritaries of WACH, CACH and the PTA Clearing House. The contact Group would be serviced by the joint secretariat (ECA, OAU, ADB, ACMS);

(b) Consultations should be held regularly among Governors of African Central Banks through the subregional associations of African Central Banks to review the monetary and financial aspects with a view to speeding up the establishment of the African Monetary Fund; such consultations should also involve the Governors of the Central Bank of Central African States [Banque centrale des Etats de l'Afrique de l'Ouest (BCEAO)]; the West African Clearing House; the Central African Clearing House; and the PTA Payments and Clearing House;

(c) The report of the Contact Group should be submitted to the next meeting of Governors of African Central Banks to be held immediately before the meeting of the Conference of African Ministers of Finance on the establishment of the African Monetary Fund. To this end, the Central Bank Governors should constitute a body to provide technical support and advisory services to the meetings of the Conference of African Ministers of Finance on monetary and financial issues;

(d) The joint secretariat (ECA, OAU, ADB and ACMS) should in the meantime, revise the feasibility study taking into account recent developments in the financial and monetary fields at the subregional, regional and international levels. Where significant changes have occured new and concrete proposals should be made in the structure and operations of the proposed Fund to be examined by Central Bank Governors at subsequent meetings.

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ISSUES FOR THE JOINT STATEMENT OF AFRICAN GOVERNORS IN THE IMF AND WORLD BANK

I. Background

1. The economic and social crisis which has engulfed our continent since 1983, has become severely aggravated. The outlook for 1988 and beyond is even gloomier than had previously been anticipated. This was recently underlined by the ECA's Executive Secretary where he declared: "And both fundamental restructuring process and the wide-ranging reforms that have been initiated and pursued in most of African countries in the last two years or so, and the entiring efforts at policy reforms appear to have generally had little effect or met with development impasse, and not, as it had widely been hoped and expected with significant improvements in the economic performance of the region." 1/ It is against the background of the slump in commodity prices, the reduced level of resources inflows and the excruciating debt burden that cu-rent trends in the economic and social situation in Africa should primarily be judged. ECA's estimates for total regional output indicate an average rate of growth of only 0.8 per cent in 1987 which compases with 0.5 per cent in 1986 and in the face of the prevailing average rate of population growth of about 3 per cent and high levels of unemployment, imply a further deterioration in overall living standards.

II. Structural adjustment and policy reforms with emphasis to APPER and UNPAAERD

2. Under these circumstances, it is clear that a substantial amount of resource flows will be required to sustain the process of economic recovery during the APPER period, up to 1990 APPER and UNPAAERD period being 1986-1990. Both APPER and UNPAAERD recommended an improvement in the quality and modality of external assistance and cooperation through, among others, greater emphasis on programme support in the priority areas of the recipient African countries, a speeder disbursement of funds, increases in aid concessionality, particularly as regards the grant element in the development assistance to African countries and giving more consideration to the recurrent and local costs of programmes and projects. The programmes also, recommended that measures should be taken by the international community in support of Africa's policy reforms. These included a greater emphasis on non project aid including balance of payments support increase multilateral concessional assistance to Africa, particularly through the rapid implementation of the IMF/IBRD structural adjustment facility and the speedy replenishment of IDA at levels commensurate with the support needed by African countries.

1/ Professor Adebayo Adedeji: "African Recovery in an uncertain and unstable international economy." Statement made at the opening of the Twenty-Third Session of the Commission/Fourteen Meeting of the ECA Conference of Ministers, Niamey, 14-18/4/88.

3. It should be clear that, in general, the nature of the structural adjustment programmes measures is such that: (a) each African country acts individually in its dealings with the international financial and donor community, whether at the bilateral or the multilateral level; (b) the measures tend towards the repetition of the existing conditions, especially the dependence on external financial flows, the extreme external orientation of production and trade, and the non-integration of the domestic economy; and (c) there is a failure to fully mobilize domestic resources, material and human, in the drive for true development.

4. Given existing conditions in Africa and trends in international relations, it would be useful for the World Bank to define what would be of a fully "structurally adjusted" African country. This should be an integrated self-reliant, self-sustaining and developing economy, as the Lagos Plan of Action and the APPER envision, and should not primarily be dependent on externally generated financial resources. It is difficult to avoid the conclusion that the adjustment measures currently being implemented by African countries are likely to lead to [illegible] at variance with those envisioned by the Lagos Plan of Action and APPER.

5. A principal characteristic of current structural adjustment programmes in sub-Saharan African countries is their direct dependence on external financial flows [illegible] linked to the IMF/World Bank, the international private banks and the transnational companies. Largely because of this dependence, countries undertaking the structural adjustment programme are obliged to surrender control over critical elements of national economic policy to external determination with serious political implications. This applies in all matters affecting credit, public expenditure and wage levels, the value of the national currency, imports, exports, external payments, investment, and the nature and extent of public ownership within the economy.

6. The degree to which external interests determine the particular political policy measures adopted by a country depends obviously on the specific conditions under which the adjustment programme is adopted, including the strength and the political orientation of the country in question. The depth of the crisis affecting the local political economy, and the prevailing international environment is also a matter that requires attention. But in all cases the macro-economic framework is fundamentally conditioned by the external factors described above. This may take the form of the direct introduction of a package of policies into the African country or, less directly, through "technical advice" under the guise of prerequisites for obtaining relief from other sources.

7. It is therefore important that the World Bank and the IMF should give serious thought to the political and social implications of the structural adjustment programmes designed for African countries. Recent political disturbances arising out of implementation of some of the IMF economic policy reforms are an indication of more deep-rooted problems than mere short-term balance-of-payment adjustments. The problem encompass the entire spectrum of political, economic and social inter-relationships within a given economy. More constructive dialogue is needed between the World Bank and IMF on the one hand and the country concerned on the other, to agree on programmes of structural adjustment and economic policy reforms that would effectively address the African economic crisis.

III. The External Debt Crisis

8. Two years after the adoption of the UNPAAERD, African countries have taken various measures designed to mobilize financial resources for the implementation of the programme. But it had to be understood that these measures had to be supported by increased resource flows. It is not however clear that the international community has taken similar steps with regard to the implementation of its commitments in the priority programme. Disbursement from donors and creditors have so far fallen short of expectations while in some instances, commercial bank lending and export credits have almost dried up. It is disappointing that the international community has so far not taken concrete and positive steps to increase financial flows to Africa. Although there has been some rescheduling and cancellation of debt during 1986 and 1987, the resource flows required to support the efforts of African countries undertaking structural reform measures have still remained inadequate. And if the same structure and finance modalities trend continue up to 1990, the African Region as a whole would be trapped into a structural indebtedness situation. In 1987, the financing conditions have tended towards less concessionality and more privatization of debt. This has undoubtedly increased the already growing debt burden of the African countries and has indeed induced a demand for more fresh resoruces to enable the countries to merely pay their obligations. The supplementary resources needed would no doubt result in increased indebtedness and an erosion of the credit-worthiness of many African countries.

9. The prospects for 1988-1990 are not quite promising either. The outlook of commodity prices is bleak; the international financial markets which are presently in state of disturbing flux, will be more stringent in providing funds of adequate and sufficient levels and conditions projections of debt contractions and debt stocks are naturally hazardous since a number of factors influences the country's decision to borrow and its capacity to actually receive new loans. However, it is evident from the projected debt servicing burden that the debt problem will continue to be an intractible

dilemma for the whole Africa. This will prevent a sustainable economic recovery if immediate and far reaching measures are not taken by the international community with regard to debt alleviation.

10. It is in recognition of the continuation of this cirsis that the Heads of State and Government of the Organization of African Unity adopted in December 1987, the"African Common Position on Africa's External Debt Crisis." This urged the developed creditor countries and international financial institutions to consider the suspension of Africa's debt service obligations for a period of ten years in accordance with the commitment they made to substantially increase the resources available to African countries to implement the United Nations Programme of Action for African Economic Recovery and Development 1986-1990 adopted by the United Nations General Assembly in June 1986. The African Heads of State and Government also called for an international conference on Africa's external indebtedness to engage in a constructive dialogue to resolve Africa's debt problem. The IMF/World Bank is urged to support the conference.

IV. Mobilization of National Savings

11. Developing African countries have a savings potential which existing financial Institutions often have not turned to best advantage. Among the principle mechanisms for the mobilization of this potential are contractual savings institutions which can contribute significantly to the allocation of internal resources for economic growth. Such Institutions should therefore be back stopped by the World Bank to improve the mobilization of domestic savings and steer them towards development financing. This can be achieved through a combination of the following means: (i) improving the functioning of traditional financial bodies and supporting the creation of new and innovative ones such as credit dispensing and savings collecting institutions, commercial banks, national development banks; (ii) establishing links between formal and informal savings mobilization circuits; (iii) offering a wider and more adapted range of savings opportunities to the population; (iv) seeking better linkages between the savings mobilized and the credit function, with special efforts to use savings locally.

12. The World Bank could help in this respect by emphasizing in the course of its normal operations those programmes and projects which result in the mobilization of domestic resources and their compiling with external funds. This may be achieved by measures such as the following: (i) inducing flows of previously untapped local savings in those countries which benefit from

technical assistance and loans so as to maximise the savings generation effect of the development finance to which these multinational institutions contribute; (ii) promoting the modernisation of financial markets in developing African countries, both directly through equity investments in local companies and indirectly by fostering policy measures leading to the same overall objective.

13. It would also be useful if special attention must be focused on: (i) the use of local counterpart financing which is genuinely derived from domestic savings and not from mere monetary creation or loans from other sources; (ii) the maintenance of an acceptable ratio of local savings to external resources, adjusted to the specific requirements of each country and sector; (iii) an increase in the proportion of loans granted to medium- and small-scale enterprises or small-scale projects so as to favour the generation of local savings; (iv) the adotpion of policy measures and reforms in national financial systems which would result in the modernization of capital markets and of financial intermediaries.

V. Conclusions

14. As has been demonstrated over the past five years or so, despite the IMF/World Bank policies for stimulating a healthier and more balanced process of economic growth, the inescapable results have been the intensification of the economic and social crisis. We now experience lower levels of economic activities, decapitalization of sector geared to meeting domestic demand, unfair competitive edge given to transnational manufacturing and mining establishment geared to exports. The structural adjustments and economic policy reforms have in some cases exposed the countries to the risks of political disturbances such as the so-called "food riots". To avoid the continuation of this situation, the IMF/IBRD's structural adjustment and economic policy reforms need to be human-oriented, and articulated around (i) the necessity to ensure the retention of the surplus being generated within the domestic economy for the purpose of internal social and economic transformations; (ii) the unhindred right to develop and design alternative economic and political models that respond to the real needs and aspirations of the vast majority of African people; and (iii) a radical modification of the IMF and World Bank's approach to the transformation of the existing economic structures in Africa and the genuine search for alternative models of development based on sub-regional and regional economic co-operation and integration as a basis for more viable investment propositions. Domestic and inter-African trade should be built into future lending programmes to Africa as a basis for self-sustained growth of the African economies.

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ECONOMIC COMMISSION FOR AFRICA

First 1988 Meeting of the Working Party of African Governors in the IMF and World Bank

Gaborone (Botswana), 25-29 July 1988

LC/AM/1988/1

ISSUES FOR THE MEMORANDUM TO THE PRESIDENT OF THE WORLD BANK

I. Introduction

1. A number of disappointments characterized the economic performance during the year 1987 and prospects for 1988 seem to be worse 1/. A recession in 1988 in the major industrial economies will have dire consequences for the African region in terms further reduced resource flows and possibly higher interest rates, which would increase the already heavy debt burden of African countries.

2. The uncertainty over future prices for all commodities also dim the prospects increase in exports earnings and the overall international trade relations of most of the African countries.

II. Resource Flows

3. There is no doubt that the support of the Bretton Woods Institutions, namely the World Bank is indispensable especially in the implementation of Africa's Priority Programme for Economic Recovery (APPER 1986-1990). Bearing in mind the sharp decline in ODA in real terms over recent years, the World Bank ought to undertake special efforts to mobilise more resources on concessional terms for African countries especially the least developed ones. In this context, it should persuade the developed countries to increase the Official Development Assistance to reach the target of 0.7 per cent of GNP as called for in the International Development Strategy for the third United Nations Development Decade. The developed countries should also be urged to honour their commitment to provide 0.15 per cent of their GNP to the Least Developed countries as called for by the Substantial New Programme of Action.

4. Africa should strongly appeal to the World Bank to persuade the industrial countries to take measures designed to encourage their commercial banks to resume and increase their investment and lending to African countries especially during the APPER and UNPAAERD period.

III. The Capital Base of the Bank

5. The resources of the World Bank have become the major funding for development financing in Africa. The need for more resources to implement APPER and UNPAAERD constitutes a strong argument for a substantial increase in the authorized capital of the World Bank with a view to expanding its lending programme in real terms to African countries especially during the period of the programme 1986-1990. African countries have noted with concern that the major donors do not envisage any capital increase in the near future. It is agreed that the World Bank should be urged to persuade the major industrialized countries to reconsider their position in this important matter.

1/ For more details, see E/ECA/CM.14/4: «Survey of Economic and Social Conditions in Africa 1985-1987, pages 17-49.

IV. New financial instruments

6. The pattern of borrowing by African developing countries in the 1970s has revealed the danger of heavy reliance on a single source of credit, especially in the context of fast-changing capital markets. Bank lending has so far transferred most risks to the borrower, including the exchange rate risk, the interest rate risk and especially the risk of mismatch between foreign exchange earnings and debt service obligations. However, this transfer of risks to borrowers has at the same time increased the credit risk to be borne by lenders. The main issue is therefore how new pattern of flows should evolve desirable features of a new pattern of finance that ensures a more balanced risk-sharing between lenders and borrowers; a diversification of sources of finance both to increase the volume of resources and to bring greater stability to the supply of finance, and a better distribution between debt-creating and non-debt-creating instruments, to reduce mismatching of changes in debt-service obligations and in foreign exchange earnings. The new financial instruments should include equity finance, including portfolio investment, bank lending with new modalities, various forms of quasi-equity financing, such as commodity bonds, and variants of project finance such as production-sharing arrangements or improving the traditional financial bodies such as national savings channels.

V. Mobilization of National Savings

7. Developing African countries have a savings potential which existing financial institutions often have not turned to best advantage. Among the principal mechanisms for the mobilization of this potential are contractual savings institutions which can contribute significantly to the allocation of internal resources for economic growth. Such institutions should therefore be back stopped by the World Bank to improve the mobilization of domestic savings and steer them towards development financing. This can be achieved through a combination of the following means: (i) improving the functioning of traditional financial bodies and supporting the criterion of new and innovative ones such as credit dispensing and savings collecting institutions, commercial banks, national development banks; (ii) establishing links between formal and informal savings mobilization circuits; (iii) offering a wider and more adapted range of savings opportunities to the population; and (iv) seeking better linkages between the savings mobilized and the credit function, with special efforts to use savings locally.

8. The World Bank should in this respect by emphasizing in the course of its normal operations those programmes and projects which result in the mobilization of domestic resources and their compiling with external funds. This may be achieved by measures such as the following: (i) inducing flows of previously untapped local savings in those countries which benefit from technical assistance and loans so as to maximize the savings generation effect of the development finance to which these multinational institutions contribute; (ii) promoting the modernisation of financial markets in developing African countries, both directly through equity investments in local companies and indirectly by fostering policy measures leading to the same overall objective. In doing so, special attention must be focused on: (i) the use of local counterpart financing which is genuinely derived from domestic savings and not from mere

monetary creation or loans from other sources; (ii) the maintenance of an acceptable ratio of local savings to external resources, adjusted to the specific requirements of each country and sector; (iii) an increase in the proportion of loans granted to medium- and small-scale enterprises or small-scale projects so as to favour the generation of local savings; (iv) the adoption of policy measures and reforms in national financial systems which would result in the modernization of capital markets and of financial intermediaries.

VI. The Debt's Strategy

9. Over the past ten years, there has been a dramatic increase in the total debt of African countries as well as the debt servicing obligations. The problem of external debt arises from three main factors: decline in foreign exchange earnings due in a fall in prices of commodities; the decline in the inflow of development financing; and the mounting debt service obligations. According to calculations by ECA secretariat, the trade balance switched from a surplus of $5.9 billion in 1985 to a deficit of $7.5 billion in 1986 and is estimated to be US$7.3 billion in 1988. The current-account deficit reached $21.5 billion, and calculations for 1988 estimate it at US$18.2 billion a much worse result than that was anticipated. There was a further accumulation of payments arrears. Total debt reached $200 billion by the end of 1986 amounting to 66 per cent of GNP and more than 200 per cent of export earnings. The average debt service ratio is now about 35 per cent compared to 7.5 per cent ten years earlier. In a quarter of African countries, this ratio exceeds 50 per cent, and reaches unsustainable levels of 100 per cent or more in some cases. Interest payments amounted to 14 per cent of exports. Net financial flows to sub-Saharan Africa had already been cut by half between 1981 and 1984 and continue their decline.

10. External resource flows in 1986 amounted to only US$18 billion including debt cancellation and rescheduling which showed a decline of 60 per cent of the 1981 level. Estimates by the IMF show that Africa's external debt has reached US$220 billion in 1987 and debt service amounted to US$27 billion. Projections, based on the continuation of the current trend, indicate that unless some urgent measures are taken to deal with the African debt issue, by 1995 the total debt will have reached US$313 billion, with annual debt service payments of US$31 billion. Looking further into the future, it is estimated that by the year 2000, the situation will even be more serious and the total debt (both short and long term) will reach about US$550 billion while annual debt service payments will exceed US$46 billion.

11. The Third Extraordinary Assembly of African Heads of State and Government held in Addis Ababa, Ethiopia, from 30 November to 1 December 1987, reviewed in detail, the deterioration in Africa's external debt situation and the excessive external debt servicing obligations of many African countries. They expressed deep concern that despite their individual efforts to resolve the crisis and despite the repeated appeals to the international community during the preceeding three years, no concrete and lasting solutions have been implemented to alleviate the debt crisis. They unanimously agreed that unless urgent action is taken, the external debt crisis will not only intensify, but will also seriously

jeopardize the very foundation for Africa's economic recovery and self-sustained growth. As a means of addressing the debt crisis the African Heads of State and Government adopted the African Common Position on Africa's External Debt Crisis and concluded that «a lasting solution to the external debt problem of developing countries can only be found within the framework of comprehensive and parallel actions in the major economic sectors, in recognition of the interdependence among the external debt issues, flow of development assistance, improved international trading system, improved commodity prices and the reform of the international monetary system».

12. The World Bank should therefore consider providing debt relief measures of its own loans especially for the least developed (low income) countries in order to alleviate their debt service obligations. In addition, the World Bank should also urge creditor countries and commercial banks to improve the terms of rescheduling by extending repayment, grace and consolidation periods. The conversion of a substantial part of LDCs Debt into grants or equity ought also to be part of the World Bank's strategy aimed at solving Africa's external debt crisis.

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First 1988 Meeting of the Working Party of African Governors in the IMF and World Bank

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LC/ANNEX/81

ISSUES FOR THE MEMORANDUM TO THE MANAGING DIRECTOR OF THE INTERNATIONAL MONETARY FUND

I. INTRODUCTION

1. The unfavourable international economic and financial environment in which adjustment programmes are implemented in Africa is still dominated by the continuing high real interest rates and the instability in exchange rates of the major world currencies. Moreover, the never ending decline in commodity prices still constitutes a major obstacle to any attempt by African countries to increase their export revenue. This is being aggravated by the sharp decline in resource flows in real terms to Africa, especially the official development assistance (ODA) and the already acute balance-of-payments of many African countries. The overriding issue is that the volume of financial flows to African countries is inadequate to support the current economic growth, efforts, structural adjustment and debt service obligations.

II. STRUCTURAL ADJUSTMENT PROCESS

2. The African countries are implementing structural adjustment programmes under trying circumstances and with scanty resources. So far, some of the industrial countries with preponderant weight and influence in the world monetary and financial problems do no seem prepared to take steps to reduce their considerable fiscal and external deficits. The failure of those large countries to adjust their policies and implement appropriate measures conducive to world economic recovery and growth, continues to shift the burden of adjustment to developing countries. Therefore, IMF surveillance of the economic policies of the industrial countries should be strengthened in the light of its mandate contained in its article of agreement, so that countries concerned introduce appropriate corrective measures.

3. New guidelines are needed for IMF supported programmes in Africa which have had limited effectiveness so far. It appeared (a) that while programmes tended to strengthen the basis or overall balance of payments, the known statistical significance of the results was low and the achievement often fell short of programme targets, which tended to be over-ambitious: (b) only in some cases did the Fund programmes result in significantly larger inflows of capital from other sources and there was no systematic association at all between programmes and sustained liberalisation of trade and payment (c) programmes did not generally have strong deflationary effects, although there were indications that such effects were becoming stronger in the more recent years. Interestingly Fund assessments themselves made only modest claims to success. It also became apparent that both stand-by and extended fund facility programmes were subject to fairly frequent breakdowns. Extended fund facility programmes probably brought smaller balance-of-payments benefits, and overall evidence did not support the view that extended fund facility programmes resulted in significant improvements in the export performance of the countries concerned.

III. Fund's Resources

4. It is obvious that proceeds from quota subscriptions are the main source of resources for the institution. However, in the light of the preponderant role of the quota in determining the number of voting shares, the amount of access to the resources of the institution, and entitlement to SDR allocations. However it is urged that criteria's fund for calculating and distributing quota be fundamentally recast, with due consideration given its cooperative nature.

IV. Access to Fund Resources

5. It is understood that the existing Compensatory Financing Facility (CFF), through which the Fund compensates for temporary shortfalls in export earnings will be combined with a new external contingency mechanism in a single facility. Moreover during the last spring meetings of the Interim-Committee, it has been agreed that the extended Fund Facility which assists members in meeting external payments over a longer period and in larger amounts than under stand-by arrangements, will also be strengthened and the Interim Committee noted that the conclusion of agreements with a number of contributor countries would soon permit the Enhanced Structural Adjustment Facility (ESAF) to become operational. Nevertheless, the need to ameloriate Africa's economic performance by injecting these facilities should not overshadow the painful consequences of the application of the concept of conditionality and the evaluation of the outcome of the policicies implemented.

6. For many reasons, there is a strong case for modifying the content of conditionality - at least, a reversion to the late-1970s attempts to adapt it to developing country circumstances. The case flows from the articles of agreement. given the changing nature of its clientele and their problems, the Fund's traditional conditionality reduces its ability to carry out certain of the purposes written into its articles. So far as the former are concerned, we urge the case for adopting a richer mix of policies and the principle that the design of programmes should be related to the causes of the problems they are intended to resolve. We urge the concious adoption by the Fund of a 'cost-minimisation' principle in designing its conditionality for any given country, that is it should examine alternative courses of action on the balance of payments and select that which is most in harmony, or least in conflict, with other objects of government policy. This implies giving greater weight to the "primary objectives" of policy, to the distribution of income and to the political implications of the proposed measures.

7. While we agree with the Fund's principle of uniformity of treatment amongst members, we suggest that greater weight be placed on the differential ability of governments and public administrations to formulate and execute integrated packages of measures, and on the varying speed of improvement it is realistic to

anticipate. Taking countries' differing "capacities to transform" more into account would move the Fund in the direction of longer-term programmes in the poorer LDCs. A final general recommendation is that Fund conditionality should focus on achieving a consensus with the government about desirable policy measures, with a corresponding move away from the present importance placed upon quantified performance criteria relating to domestic credit and a few other macroeconomic variables.

8. Indeed, there is no dobut that present Fund policies do not offer deficit countries a soft option a way of obtaining a lot more money without taking tough policy measures. We are urging the Fund - and more particularly the country representatives who decide its policies - to have the courage and convictions to adapt conditionality to the impact of the second oil shock in 1979-80. It is true that if it were to move far in the direction we propose the Fund would need larger resources. We also believe that there is need for policy changes by many LDC governments: limitations of space prevent us from developing these themes here. It should also be remembered that any success which oil-importing developing countries might have in reducing their deficits relies on the willingness of other countries to see their payments positions weaken. For as long as the international environment remains characterised by protectionist anti-trade policies and deflationary macroeconomic policies in industrial countries, the scope for adjustment through the domestic efforts of LDC governments will remain severely limited.

V. Africa's External Indebtedness

9. Africa's debt servicing problems continue to constitute a very heavy burden on the economies of the countries by draining away much needed foreign exchange. Debt rescheduling which is presently adopted to solve the debt crisis of African countries, constitutes only a relief of a temporary nature, and in fact, aggravates the debt service problems in later years. Moreover, rescheduling is always tied to a prior agreement with the IMF on a set of economic programmes and policies to be implemented which sometimes create more economic and social hardship than they solve. We appeal to IMF to design more flexible programmes and policies for countries applying for a debt rescheduling. We also feel that the IMF ought to encourage creditors to improve their rescheduling terms for African countries by allowing longer grace and maturity periods as well as lower interest rates. Some creditors also ought to be urged to cancel some or all of the debt of African countries or to convert part or all of the debt into grants or equity. Since the IMF itself has become a major creditor of many African countries, it ought to set up a new mechanism to help those African countries which, because of exogenous factors, are unable to repay their obligations to the Fund on schedule.

10. Since there is no way out of the debt problem without a reversal of the negative transfer of resources and a reduction of the debt overhang, the IMF, although looking into the possibility of establishing a new credit facility designed to alleviate the debt service burden of African countries caused by

high real interest rates, should also be urged to support and participate actively in the convening of an international conference on Africa's external indebtedness whose aim will be to devise short medium and long term solutions to the debt crisis of African countries.

VI. Reform of the International Monetary System

11. There appear to be a general consensus that the present international monetary system concentrates the decision making power in money and finance amongst the few highly developed countries of the world and is unfair to developing countries. Therefore the system ought to be reformed to ensure the effective participation of developing countries in the decisions on money and finance which affect the economies of developing nations as much as they affect those of developed nations. An international conference on money and finance for development ought to be convened to discuss modalities of a new international monetary system, that would be fully responsive to the needs of developing countries.